

TO: Files

CC: San Diego Audit Committee

FROM: Willkie Farr & Gallagher LLP

RE: San Diego Audit Committee Investigation
October 21, 2005 Interview of Eric Adachi

DATED: November 8, 2005

On October 21, 2005, Michael Schachter and Michael Shapiro, in Willkie Farr & Gallagher LLP's capacity as counsel to the Audit Committee, interviewed Eric Adachi from the City of San Diego Financing Services Department, at the City Administration Building ("CAB"), 202 C Street in San Diego, in a conference room on the third floor. Mr. Adachi was not represented by counsel, but Rod Greek from the City of San Diego Auditor's Office was present as Mr. Adachi's representative.¹ Mr. Adachi requested the opportunity to record the interview. Mr. Schachter said that interviews are not normally recorded but if Mr. Adachi would like to record it, the Audit Committee would like it recorded, as well. Mr. Adachi stated that this was acceptable, so the interview was recorded by the Audit Committee. Mr. Schachter requested that Mr. Adachi keep the substance of the interview and the tape confidential.

The following memorandum reflects my thoughts, impressions and opinions regarding our meeting with Mr. Adachi and constitutes protected work product. It is not nor is it intended to be a transcript of the interview.

Warnings

Mr. Schachter informed Mr. Adachi that we are counsel to the Audit Committee and do not represent him or any employee. He advised Mr. Adachi that the interview may be considered attorney work product and confidential, but the decision of whether to keep it confidential will be made by the Audit Committee and the City, not Mr. Adachi. Mr. Schachter said we will create a report which may contain statements of employees, and this report will

¹ Mr. Schachter requested information from Mr. Greek to ensure that he had no involvement with issues relevant to the investigation. Mr. Greek said that he works at the City Auditor's office and worked for five years prior to that time at the water/sewer design division where he helped manage capital. Prior to that time period, he worked in Improvements with the Audit Division at the City Auditor's Office. He said he reported to Tony Salmon and Heidi Reed-Falk. He said he had no role in sewer user rates and no role in bond disclosures, but did provide CIP to the Wastewater and Water Departments, including information on rates. He said he had no role in MP1 or MP2. However, from February to April 2005, he worked on the footnotes to the Fiscal Year 2004 financials. Mr. Schachter requested that Mr. Greek not discuss with others the questions or answers propounded or elicited from this interview.

likely be provided to KPMG. He said government agencies may also view the report so it is important to be truthful and accurate.

Background

Mr. Adachi received a BA in Economics from the University of California-San Diego in 1985. He began work in San Diego in 1994 as an administrative trainee and then worked in the Development Services Department for two to three years. He then worked for Financing Services as an Associate Economist, working with bond financing and the "rate case." He is now a Rate Analyst/Supervising Economist, a position in which he deals with sewer rates and bond financing for the Sewer Department. He joined Financing Services in 1997, which is a division of the Treasurer's Office, where he is mostly involved with bond financing. Bond financing involves issuing Requests for Proposals ("RFPs") for consultants/advisors, interviewing underwriters, providing information to structure deals, creating the financial model and rate case regarding rate increases to finance bonds, and generally working under Dennis Kahlie. When he started work as an Associate Economist at Financing Services his supervisor was Phil Moffitt, a Rate Analyst for Sewer at the time. Mr. Adachi focused on sewer financing. In 1997, he learned how to work with the financing model, loading data and determining rate increases. Before the 1999 bond issuance, Moffitt left San Diego for the Massachusetts Water Authority. Thereafter, Mr. Adachi worked for Kahlie. The 1997 issuance was "wrapping up" when Mr. Adachi began working for the City. He had no role in doing the annual reports of the Metropolitan Wastewater Department. Mr. Adachi inherited files from Moffitt and never decided what should be saved; this accounted for a number of documents being in his possession that he had nothing to do with.

Wastewater

Mr. Adachi reviewed Exhibit 1, undated handwritten notes (DK05423). He did not recognize the handwriting. Mr. Adachi was shown Exhibit 2, a May 14, 1998 City of San Diego Sewer Cost-Of-Service Report ("COSS") (MWWD-BH0950-0991). He was not involved in the November 20, 1997 COSS and does not know why it was done. He said the May 14, 1998 COSS (MWWD-BH0950-0991) did not look familiar. In 1998, he was aware that San Diego received the COSS and that San Diego was out of compliance with the requirements of the State Water Resources Control Board ("SWRCB"). The COSS laid out how rates should be changed. He was aware of the general facts in the May 14, 1998 COSS but did not read or focus on it. He was learning the rate model at that time and was not involved in the COSS.

Mr. Adachi reviewed Exhibit 3, a March 26, 1998 memo from Lynn Phelps to Distribution List, re: "Notes from meeting on COD Requirements of March 18, 1998" (COS002155-2159). Mr. Adachi does not recall the meeting but is familiar with the topics. The issue being discussed was implementing the COD component into the Customer Information System ("CIS"), the billing system, so that COD would be a parameter for sewer costs. Mr. Schachter showed Mr. Adachi Exhibit 4, a letter dated September 30, 1998 from Ronald R. Blair to Hedy R. Griffiths, re: Proposed Regional Wastewater Disposal Agreement (EA00053). COD was a new parameter that needed to be added as part of the user charge system. Mr. Adachi said that previously only TSS and flow were components. He now knows that COD is an SRF requirement but cannot say he knew it then. He was aware at the time that the Participating Agency (PAs) contracts were changing to include rates that included COD and he remembers the

PAs changing their rate structures in 1998. San Diego was looking at changing the rate structure for San Diego users as well but he does not know at what time the COD component was added for municipal customers.

Mr. Adachi reviewed Exhibit 5, a list of "Required Items for the Wastewater System Preliminary Official Statement," with handwritten notes, hand-dated December 2, 1998 (DK08862-008863, DK08859-08860). Mr. Adachi said that the handwriting on the documents is Dennis Kahlie's. EA is Eric Adachi; Jenna is from Orrick; Paul is Paul Webber; Darlene is Darlene Derose; and Christine is Christine Reuss, Mr. Adachi's equivalent on the "water side." He does not remember a phone conference on December 2, 1998. He is familiar with the list of required items but does not know who prepared it. He could have prepared it. Exhibit 5 lists who will provide information for each piece of the Preliminary Official Statement. Kelly Salt and Jacqueline Mittelstadt (now Lindsay) provided information for the particular sections noted in Exhibit 5 and were responsible for reviewing the entire Preliminary Official Statement. He does not recall a 1999 Bond Disclosure "page turner" but said it did occur and he would have been in attendance.

Mr. Adachi reviewed Exhibit 6, a December 14, 1998 letter from David McKinley to Bill Hanley re: "Specific Problems with Wastewater Strength-Based Cost Allocation Factors" (COS001317-001326). In 1998, San Diego was working on implementing SBB to include COD in the rate structure. Adachi met with Kelco. Kelco claimed that due to discharge strength, Kelco would be severely impacted if the rate structure changed. He said the December 14, 1998 letter is Kelco's rationale for why it was unfair to implement the new rate structure. In 1998, he cannot recall when the PAs began including COD in the rate billing structure but probably did know that it occurred at that time.

Mr. Schachter asked why the PA rates were changed to include COD in December 1998. Mr. Adachi believes he was aware of the State requirements regarding COD. He had a role in the preparation and review of the March 1999 Sewer Bond Official Statement. He collected information and passed it on or updated the Official Statement himself.

Mr. Adachi reviewed Exhibit 7, a March 2, 1999 Sewer Revenue Bond Official Statement (COS005874-006042). Mr. Schachter asked Mr. Adachi whether he had any role in preparing pages bates-stamped COS005904-005905. Mr. Adachi said he did not. He would have read the Official Statement but was not responsible for updating it. He believes the statement was similar to the 1997 Official Statement.

Mr. Schachter asked Mr. Adachi who was responsible for pages COS005904-005905 of Exhibit 7. Mr. Adachi said that everyone was responsible for reviewing it. The accuracy of the section was determined by outside bond counsel in conjunction with conversations with Metro Wastewater people including Bill Hanley, Clay Bingham, and David Schlesinger.

Mr. Schachter asked Mr. Adachi who drafted the language, "no grant funds or costs under grant funded programs have been disallowed..." on page COS005905. The language was drafted before Mr. Adachi came on board and he does not recall a direct discussion regarding this line. He was aware of the 1998 COSS at the time the POS was being reviewed

Mr. Schachter asked Mr. Adachi if there were any discussions regarding disclosing that the sewer rate structure was non-compliant with the State's requirements. Mr. Adachi said that since the State had not sent a letter of noncompliance, the feeling was that the "disallowed" language was not inaccurate but he does not recall a specific conversation about the line. It has "always been the sense" that if there was no letter stating San Diego was out of compliance, then San Diego was not out of compliance. He has trouble remembering whether that was the feeling at that time. He said he was "not stating that the language was fine because there was no non-compliance letter." He then said he was "not understanding the language was incorrect because San Diego had not received a non-compliance letter." Mr. Schachter asked who held this latter view. Mr. Adachi may have spoken at the time with Kahlie who concurred with this view. Once San Diego received subpoenas, it was apparent this was a concern. He may have spoken with Reuss and Kahlie regarding this issue.

Mr. Schachter asked whether Mr. Adachi recalls Orrick being informed about noncompliance of the rates. Mr. Adachi cannot recall Orrick being specifically informed that rates were not in compliance with State requirements. At "page turners," typically everything on the page was discussed, but he cannot remember the "page turner." He believes noncompliance and the COSS were discussed during the "page turner" when outside counsel was present. He believes outside counsel knew and understood about the noncompliance as evidenced by the language used in the Official Statement. He believes bond counsel drafted the language. He does not believe that the "disallowed" language is a significant omission. Were the State to issue a noncompliance letter, San Diego would change the structure or have to repay the loans. The disclosure does not say the City is fully compliant, it says that no grant has been disallowed.

Mr. Schachter asked Mr. Adachi whether outside counsel was informed that San Diego would change the rates if it received a letter from the State. Mr. Adachi believes outside counsel was so informed. Mr. Schachter asked Mr. Adachi whether he was aware of the Clean Water Act regulations regarding proportionate use. He was not. Mr. Schachter asked Mr. Adachi whether he was familiar with a City Attorney legal opinion in November of 2002 on this issue. Mr. Adachi thinks he probably received it. He recently discussed with Kahlie and Reuss whether outside counsel knew the structure was not in compliance. He and Kahlie agreed that Webber knew the exact situation. Kahlie told him that Kahlie recalled having conversations with Webber where this was discussed at length but Mr. Adachi does not recall the conversations. Mr. Adachi believes allocating costs based on COD is a contractual requirement, but not a legal requirement.

Mr. Schachter asked Mr. Adachi whether, in the late 1990's, Salt or Mittelstadt knew of the lack of compliance. Mr. Adachi believes they did. He said it is hard to believe that Salt did not know. The City Attorney's Office "is involved in all these types of issues" and would be aware if they had a letter from the State and whether they were in or out of compliance with any State or federal laws.

Mr. Schachter asked Mr. Adachi about the role of Ted Bromfield. Bromfield attended some meetings and handled wastewater litigation. Bromfield negotiated San Diego's move to secondary treatment, and would review litigation and the final order section of the disclosures (at COS005905). In the late 1990's, Bromfield probably knew that the State could ask for the return of SRF money if there was noncompliance.

Mr. Schachter asked Mr. Adachi if he considered whether potential liability for repayment of the SRF loans needed to be disclosed. Mr. Adachi knew that the rate structure was required to be in compliance regarding the COD component, knew that San Diego's rate structure did not include a COD component, and understood that San Diego was in breach of contract. However, he gave no thought to disclosing noncompliance with the SRF contract as a liability.

Mr. Schachter asked Mr. Adachi whether there were any discussions in 1998 to 1999 regarding whether SRF noncompliance was a liability. Mr. Adachi believes such a discussion took place with Kahlie. It was Kahlie's opinion that should San Diego get a noncompliance letter, San Diego would comply. Therefore, it was not a liability because San Diego was not in danger of having to pay back the loan. He does not recall discussing the issue of liability with anyone else specifically using the term "liability."

Mr. Adachi reviewed Exhibit 8, a November 3, 1999 e-mail from Dennis Kahlie to George (Loveland) re: "Meeting with Chris Kehoe Nov 2 Re Cost of Services Study" (COS000005-000010 and COS000023) and Exhibit 9, an October 6, 1999 memo from George Loveland to the Mayor and City Council re: "Water and Sewer Cost of Service Studies" (COS000118-000119), which enclosed the 1998 COSS. While the memo enclosing the 1998 COSS states that it was Kahlie's view that changes were not recommended, that was not Kahlie's position. Kahlie believed changes were needed. Mr. Adachi probably saw the memo prior to today. He did not have any recollection of preparing the memo. He does not recall any conversations regarding the circumstances of the memo. He believes someone from the City Council had requested the COSS and that is why it was produced. He is sure that he had conversations about the memo but does not recall them.

Mr. Adachi said that there was a "general sense from upper management" that the rate structure would not be changed based on the recommendations of the COSS. Upper management meant the City Manager level, including Loveland and Uberuaga. He must have heard about upper management's disdain for changing the rate structure from Kahlie. The City Manager reflects and implements the will of the Mayor and Council. It was the direction from the City Manager to recommend "no changes" despite the COSS. He remembers Council members asking for the release of the COSS, perhaps Councilwoman Kehoe.

Mr. Adachi does not recall seeing Exhibit 10, a document entitled, "Sewer/Water Cost of Service Study" (DK09922-23). Mr. Schachter asked Mr. Adachi to review Exhibit 11, an outline dated March 16, 2000 entitled, "Discussion Items For Black & Veatch/Katz & Associates Contracting Session" (EA00198-00199). Mr. Adachi was familiar with Exhibit 11. He could have prepared it. It contains his handwriting.

Mr. Schachter asked why Black & Veatch was hired. Black & Veatch needed to do a sewer and water COSS because San Diego needed to have a report on how to implement the COD component. Mr. Schachter asked why one was needed, given that a COSS had been performed in 1998. The feeling was that the Pinnacle COSS was several years old, and based on data from the mid-90's. Therefore, San Diego needed updated information. It was a competitive bid process and Black & Veatch was the most competitive. Mr. Adachi did not know why the COSS was done after Kahlie's October 6, 1999 memo was issued stating that no changes needed

to be made. He believes Black & Veatch was supposed to complete it in one year but it took a lot longer.

Mr. Adachi reviewed Exhibit 12, a facsimile from Eric Adachi to Sudhir Pardiwala referencing correspondence with Blair regarding the City's rate structure, dated September 5, 2000 (EA00239). Sudhir is the project manager at Black & Veatch. Mr. Adachi believes Black & Veatch received responses to their informational requests including their request for correspondence from the State.

Mr. Adachi reviewed Exhibit 13, a facsimile from Eric Adachi to Sudhir Pardiwala and Prabha Kumar, attaching correspondence Hanley sent to Mr. Adachi regarding direction from the State to the City on the subject of an oxygen demand component in the billing structure, dated September 12, 2000 (EA00043-00052). Mr. Schachter asked whether there was any discussion that the State was under the mistaken impression that San Diego was in compliance regarding municipal users. Mr. Adachi stated that there was a general feeling in 2000 that the State had erroneously assumed San Diego was in compliance because of the implementation of the PAs' SBB. He discussed this with Kahlie and probably Sudhir and Mr. Kumar from Black & Veatch. This issue was laid out clearly to both Black & Veatch and Pinnacle. He probably discussed it with Reuss and Hanley as well.

Mr. Schachter asked Mr. Adachi about Kelco's role in the process. David McKinley from ISP Alginates was very active in the stakeholder process. McKinley tried a number of strategies. Initially, McKinley said it was not necessary to include organics. Then, McKinley advocated that COD was "overweighted" because it used Point Loma, which was not designed to remove BOD.

Mr. Adachi said the Stakeholders Group supported the City's methodology but not unanimously. The losing side advocated McKinley's straight TSS method, which would reduce costs related to COD removal. McKinley argued that costs for COD removal should not be allocated to costs to run Point Loma because that was not the original design. The City plan allocated TSS and COD to the Point Loma Plant and used specific procedures to increase COD removal. To obtain a permit to not be a secondary treatment facility, it needed 58% BOD removal so it needed to increase the removal of solids. McKinley's position was that there should be different rates depending on the treatment facility used. McKinley said that the costs associated with North City should not be allocated to Kelco. McKinley's position included an organics parameter.

Mr. Adachi reviewed Exhibit 14, a September 25, 2000 memo from David McKinley of ISP Alginates to the Members of the Sewer Cost of Service Stakeholders' Group, re: "Additions and Corrections to Summary of Stakeholders Group" (EA03158-03159), and Exhibit 15, an undated "Response to September 25, 2000 comments by David McKinley, Environmental Manager, ISP Alginates. Summary of discussion with Ron Blair" (EA00832). Mr. Adachi may have prepared Exhibit 15 but he does not believe so.

Mr. Adachi reviewed Exhibit 16, a September 28, 2000 e-mail from Karyn Keese to WZH (Bill Hanley), re: "Comments regarding David McKinley" (EA00833). Mr. Adachi said the document could have been forwarded to him. Mr. Schachter asked Mr. Adachi to review Exhibit 17, an October 2, 2000 e-mail from Dennis Kahlie to pardiwalasd@bv.com, PTenny, and

others, re: "Comments Re Karen Keese's E-mail" (EA00828). Mr. Adachi said that he received Exhibit 17 and that Kahlie is referring to the fact that Blair mixed up what Blair told San Diego at different times. Kahlie told Mr. Adachi that if they were going to bring Blair into the discussion, they needed to make sure Blair had reviewed the old documents so he remembered the history correctly.

Mr. Adachi reviewed Exhibit 18, a January 11, 2001 e-mail from Dennis Kahlie to Mary Vattimo, re: "Project Status" (COS007243), and Mr. Schachter asked him about Mary Vattimo's role in changing the sewer rates. Vattimo was Kahlie's supervisor and was not really involved with the COSS but was kept apprised. He was sure discussions took place where Vattimo was told of noncompliance and that she understood why the COSS was being done.

Mr. Schachter asked Mr. Adachi about the role of Vattimo and Pat Frazier in the preparation of the annual disclosures. Mr. Adachi said he does not recall sending the annual disclosures to them for review. There was no discussion that the noncompliance should be disclosed in the annual reports. There was never a major disclosure concern until the subpoenas arrived.

Mr. Adachi reviewed Exhibit 19, an October 17, 2001 e-mail from Dennis Kahlie to Scott Tulloch, re: "Fwd: Well Done" (COS004627). Mr. Adachi said he was not sure what lawyers Kahlie is referring to in the e-mail.

Mr. Adachi reviewed Exhibit 20, October 25, 2001 typed notes re: "Sewer Rates - Strength Based Billing" (CSD/MAI005800). Mr. Adachi does not believe he has seen it before but may have seen it.

Mr. Adachi reviewed Exhibit 21, a January 15, 2002 letter to Dennis Kahlie from Black & Veatch, re: "Sewer Cost of Service and Rate Design Report" (MWWD-BH0287-0351). Mr. Adachi said that it looks like the final Black & Veatch report. The COSS concludes that there is an obligation to comply with SWRCB requirements.

Mr. Schachter asked Mr. Adachi about the January 29, 2002 closed session meeting of the Council. Mr. Adachi was not invited. He believes it was the Council's decision not to move forward with the COSS and heard so from Kahlie. Kahlie said the Council did not want to impose the costs of COD because it would shift costs to the industrial plants. Kahlie was disappointed. Mr. Adachi was disappointed too because a lot of work and taxpayer money was spent on the COSS.

Mr. Schachter asked him about whether Kelco gave anything of value to elected officials. Mr. Adachi is not aware of Kelco giving anything of value or contributions to the City government. He suspected Kelco had influenced the Council, probably through lobbying.

Mr. Adachi reviewed Exhibit 22, handwritten Q&As dated February 26, 2002 (EA00410). Mr. Adachi said the notes were his but he does not remember who made the Q&As. The questions were likely directed to him. The Q&As are consistent with his views at the time. He definitely felt San Diego needed to change to the COD-based system but had still not received a noncompliance letter. He does not recall any conversations with Vattimo regarding whether if the Council buries the noncompliance issue, there is a disclosure issue.

Mr. Adachi reviewed Exhibit 23, a draft memo dated March 21, 2002 from Mark Diefenderfer to Kelly Salt, re: "City of San Diego ('City') Metropolitan Wastewater Department's ('MWWD') Compliance with Federal and State Loan and Grant Guidelines." Mr. Adachi could not recall whether Mark Diefenderfer is the same "Mark" as in the February 26, 2002 handwritten Q&As. Mr. Adachi reviewed Exhibit 24, an October 31, 2002 memo from Mary Vattimo and Kelly Salt to the Mayor and City Council re: "Significant Exposure to Litigation: Metropolitan Wastewater Department's Compliance with Federal and State Loan and Grant Guidelines." Mr. Adachi has not seen it before and was not asked to review or edit it.

Mr. Adachi reviewed Exhibit 25, a November 13, 2002 e-mail with attached "Salient Points" from Dennis Kahlie to Ed Ryan, George Loveland, Kelly Salt, Mary Vattimo, Patricia Frazier, and Richard Mendes, re: "Revision #2 to Sewer COS Briefing Document." Mr. Adachi was familiar with Exhibit 25. He had no role in preparing it. Kahlie prepared it. In Exhibit 25, Kahlie is laying out concerns about not changing the rates. The "Salient Points" were either for the Council meeting or a briefing with Council. During the last few months, Kahlie told him that the Council told Kahlie they would not change the rates until they were sued. He believes Kahlie told him the same thing back in 2002. After November 2002, he does not recall hearing of the COSS being on closed session and taken off.

Mr. Schachter asked Mr. Adachi about Exhibit 26, a November 22, 2002 memo from P. Lamont Ewell to the Honorable Mayor and City Council transmitting the "Draft Service Cost of Service Study." Mr. Adachi did not prepare the memo. Mr. Adachi reviewed Exhibit 27, a May 2002 Sewer Cost of Service and Rate Design Study (SP_SEC_SC002382-2572), which is stamped "draft." He does not recall why this COSS is stamped "draft." Mr. Adachi reviewed Exhibit 28, an October 3, 2003 letter to Dennis Kahlie from Sudhir Pardiwala and Prabha Kumar re: "Sewer Cost of Service and Rate Design Report," enclosing a COSS (EA01054-01055, 01229-01304, 01380-01381, 01406-01408, 01454). He said that it is an initial report and there were delays. He said this COSS is the updated second report which was approved by Council.

Mr. Adachi reviewed Exhibit 29, a March 6, 2003 e-mail from Dennis Kahlie to Bill Hanley, Keri Katz, Richard Mendes and Scott Tulloch, re: "Re: Cost of service study-questions" (COS005562), attaching a March 6, 2003 memo from the Utilities Finance Administrator to Head Public Works Deputy City Attorney Keri Katz, re: "Information Requested Relative To Utility Cost Of Services Study" (EA01785-01786). Mr. Adachi said he had no role in preparing the memo.

Mr. Schachter asked Mr. Adachi about Exhibit 30, a draft letter dated June 3, 2003 from Ted Bromfield to Daniel M. Deaton of Orrick, Herrington & Sutcliffe re: "Revisions in 2003 POS re: Collection System" (DK03595-03608). Mr. Adachi said that in preparation for the bonds, the City Attorney memo to Deaton parrots the "disallowed" language in the previous disclosure. He probably flipped through the memo but did not discuss the language on the third page (DK03597). Mr. Schachter asked who suggested the change in language from "annually" to "periodically" on the third page (DK03597). Mr. Adachi did not know but agreed with the change. The change may have come from him. Mr. Schachter asked if "annually" was changed, why was the language about compliance not changed. Mr. Adachi said that he did not think about it and did not discuss it with anyone. He attended meetings where the wastewater section of the Official Statement was discussed in 2003 and attended "page turners" but does not recall

worrying about the "disallowed" language. Mr. Schachter asked why Kahlie is not copied on Exhibit 30 (DK03595-03608). Mr. Adachi was surprised and said that Kahlie should have been copied on it.

Mr. Schachter asked why if noncompliance was a big issue it was not in the Official Statement. Mr. Adachi said the language was still not technically incorrect. Mr. Schachter asked if it was misleading. Mr. Adachi said that it is not misleading and does not omit important facts. No investors are in danger of default if the State issues a noncompliance letter. Mr. Schachter asked Mr. Adachi why the fact of noncompliance was not disclosed. Mr. Adachi said there were no discussions as to whether it should be disclosed. He did not think it was material.

Mr. Schachter asked whose job it was to ensure accuracy in the disclosure. Mr. Adachi said ensuring accuracy was the job of the City Attorney (Salt), bond counsel, and everyone working on it. If there was something materially inaccurate about it, someone should say something. The SRF compliance issue was not material. Mr. Adachi recalled no discussion of whether the breach of SRF contracts created a liability that needed to be disclosed.

Mr. Schachter asked whether Bromfield knew of noncompliance. He did not personally speak with Bromfield but Bromfield may have attended meetings and could have been in attendance when noncompliance was discussed. He believes Bromfield knew about the noncompliance.

Mr. Schachter asked Mr. Adachi about Exhibit 31, the Annual Report For The Fiscal Year Ended June 30, 2003 (COS003239-3246), particularly, page eight. Mr. Adachi has read it before and had no active role in preparing it, but could have provided some of the information. It was written by bond counsel and/or Salt.

Mr. Schachter asked Mr. Adachi what led up to the disclosure of the lack of compliance. Mr. Adachi said that the City had received letters from the State that said the City must prove it was in compliance, in November 2003 and March 2004, and these letters triggered the disclosure obligation. It was a collective decision among bond counsel, the City Attorney and Kahlie, to disclose. He may have attended the discussion but was not at the decision-making level. He attended meetings where it was discussed but does not recall who was there, except for the fact that Webber spoke at length. He heard Kahlie say that Webber denied knowledge of noncompliance. Kahlie told him that Webber had asserted Webber was not aware that San Diego was out of compliance with SRF requirements. Kahlie told Mr. Adachi that Webber did know and that Kahlie remembered conversations with Webber in which noncompliance was discussed. Mr. Adachi does not recall such discussions but they may have happened.

Mr. Schachter asked Mr. Adachi why noncompliance was disclosed in 2004. Mr. Adachi said they were told by the State to prove compliance. They had not implemented COD in the rates and now had a letter asking for proof and did not have the proof. In Mr. Adachi's eyes, it had now become a disclosure issue.

Mr. Adachi reviewed Exhibit 32, a November 26, 2003 letter from Ronald R. Blair to Michael T. Uberuaga, requesting proof of San Diego's compliance with SRF requirements regarding COD. Mr. Schachter asked Mr. Adachi why a press release was not

issued in November 2003, and why the City waited until March 2004 to disclose noncompliance. Mr. Adachi said, "Ask the City Manager."

Mr. Schachter asked Mr. Adachi to review Exhibit 33, a May 18, 2004 memo from Mary Vattimo to Les Girard re: "Disclosure Practices," attaching a description of events and chronologies (COS004272-004287), and asked whether Mr. Adachi had any role in preparing any part of Exhibit 33. Mr. Adachi said that he may have helped with the data but not the language. He did not disagree with it. He does not know why it was prepared and does not know who prepared it.

Mr. Schachter asked Mr. Adachi if there is any issue regarding using enterprise funds and transferring funds out of the sewer fund into the City's general fund. Mr. Adachi said, "no," but that right of way fees were paid to the general fund from the sewer fund. They were trying to phase out "right of way fees" step by step but he does not know why.

Mr. Schachter asked Mr. Adachi whether he had any other information he would like to share. Mr. Adachi said that at the staff level any kind of reason why the Council did not move forward on the COSS was not shared with him.

Mr. Schachter asked Mr. Adachi whether he is aware of anyone in City government doing anything he or she knew was improper. Mr. Adachi replied that he did not.

Mr. Schachter reminded Mr. Adachi of the Audit Committee's request to keep the interview confidential. The interview began at 8 a.m. and ended at approximately noon.

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